



Remarks by Mayor Jerry Sanders

Remedial Action Plan

September 6, 2006

Today, I formally deliver to the City Council my responses to the 121 remedial recommendations made by Kroll. Following my presentation, I will ask Jay Goldstone, the City's CFO, to brief you on each.

I have enthusiastically accepted all of the remedial recommendations made by Kroll in principle. Conceptually, I believe that it's in the City's best interests to accept them and more importantly, to implement them.

For the purposes of today, I ask that you accept and adopt the principles detailed in the remedial plan that I have offered.

These principles were spelled out in the detailed proposal that I delivered to the Council the week before last. My memo contains 33 different categories of recommendations ranging from the need for an Audit Committee to interest allocation.

This City has waited long enough. Today is the continuation of a dialogue that in some cases goes back a decade – that's how long some of these remedial measures have been around. We need to move this City forward and today is the day to get that started.

Clearly, many of the remedial measures are complicated and will require additional analysis. There are a fair number of them that will require new ordinances; others will require changes to the Municipal Code or the City Charter. Many will require vendor contracts and new appropriations. None of these actions are before you today; none will be finally adopted today.

Remedial Measures will come back for Action

Some very good questions have been posed about various remedial measures. I won't pretend to have all of the answers today because I don't.

But what I will promise you is that all of the remedial items will come back before you – either for action or as information items – at the appropriate time in a manner worthy of their importance. Those requiring your concurrence and action, such as the creation of the Audit Committee or the Monitor, will come with detailed policy proposals.

Some items, such as those requiring Charter amendments, may even come before you on multiple occasions. The first time, perhaps, with an interim solution until the voters can make their determination.

Mayor Urges Vigorous Debate

In anticipation of each of those issues, I will encourage a vigorous public debate on the implementation of each measure that involves an honest and open exchange of ideas. Our citizenry must be involved in these solutions.

By adopting my plan today, the City Council has the opportunity to send a very loud and clear message to our citizens and the financial markets that we are willing to reform ourselves. And to hold ourselves accountable in the future by correcting the mistakes that we have made in the past. Those are two incredibly important messages. But it will only happen if you adopt the detailed principles called out in my plan.

I start today by setting context for the importance of these actions that I am announcing.

Remedial Measures Give City Opportunity to Lead

There are two ways that we can choose to look upon the remedial actions. We can look upon them negatively as punishment being forced upon us or we can look upon them as a once-in-a-generation opportunity to establish a new set of best practices for ourselves and government bodies in similar situations.

For too long, San Diego has been held up as the example of how not to do things. We now have an opportunity to embrace reform and serve as an example of how a city can credibly get its affairs in order and move on to a very productive future.

In summary, we can be victims and obstructionists or we can be pioneers. I choose to be a pioneer.

Embracing the remedial actions will be the easy part. The hard part, which I intend to do wholeheartedly, is to implement them all in a constructive and thoughtful manner.

I fervently believe that the time to begin is now.

To those who oppose the remedial plan, I would ask that age-old question: if not now, when?

Implementation will Result in Transparency; Efficiency; Positive Signals to Market

At the same time, I want to make sure that this issue is treated responsibly and that expectations are managed appropriately.

Our citizens have a right to understand what results will come from the adoption of this remedial plan and more importantly, what will not happen directly as a result of its adoption.

We have a long road ahead of us and there are no easy answers. The set of problems before us are complex and as such, the solutions will be similarly complex. The problems weren't created overnight and they can't be solved overnight either.

Let me tell you what the adoption of the remedial plan will result in.

It will definitely result in far greater transparency in our financial reporting systems and practices; it will make City government more efficient and accountable to our citizens; and implementation of the plan will introduce sorely needed internal financial and managerial controls.

I believe that adoption of these actions will send positive messages to the bond rating agencies and the financial markets that we understand the depth of our past wrong doing and that we are prepared to institute corrective actions so that we never make the same mistakes.

All of these actions will give us the ability to once again access the public credit markets so that we can obtain much needed capital for public infrastructure projects.

Implementation will NOT solve City's Financial Problems

What the implementation of this remedial plan will not solve is the City's financial problems. The implementation of this plan is merely one of many steps that it will take to solve these problems.

Only fundamental changes to the ways in which we budget – and more importantly, account for long term liabilities -- will solve the City's financial problems.

I think that this is an important enough issue for our citizens to hear about that I intend to speak more about that in a few minutes.

The changes that I propose will involve sacrifice on the part of all parties – our citizens and dedicated city employees included.

Mayor has Given Careful Thought, Consideration to Recommendations

For the past several weeks, my staff and I have given each of the 121 recommendations careful thought and consideration. We haven't just accepted them at face value.

We have debated them and asked tough questions of each other. We believe that we have a good understanding of the impact of each.

But I also don't want to mislead anyone. While we have worked around the clock, we have also just had a few weeks to process the recommendations.

As such, our plan of action will be, by definition, an ongoing process that will include refinement.

And as I mentioned earlier, items will come back before you with fully fleshed out policy proposals that will reflect back on our problems and not merely offer knee jerk political solutions.

We debated whether or not we should choose certain remedial actions over others. It would have been far too easy to rationalize our way out of some as too onerous or financially costly.

Mayor Chose not to be Arbitrary about Remedial Actions

In the end, I thought it was critical not to pick and choose -- or let others do so, according to their particular likes and dislikes. I thought it was important enough to implement them all.

My thinking on this subject was influenced by three major elements.

Recommendations are the “Right Thing to Do”/Reform is Necessary

First, I think that adopting and implementing these remedial recommendations is the right thing to do. By any standard measurement, **reform is necessary**.

The vast majority of the recommendations are logical and straightforward. They are nothing more than the institution of sound business practices.

Many of them, in fact, have been in circulation for years. Some have likened the remedial section of the Kroll report as nothing more than an elaborate cut and paste job of remedial reports dating back almost a decade.

On the screen, you'll see that some of the most important recommendations have been around for a long time.

There is a sentence in the Kroll report that I think is particularly telling – and true – about City government: “The tide of history [in San Diego] seems to always favor the status quo.” We can't allow that to continue.

So, what's the difference between then and now? I think it's the responsibility of a strong mayor to bring the will to make changes. Previously, we had perennially-debated problems. Now, we have solutions.

Some of the recommendations are appalling in how obvious they are; the changes should have made been instituted a long time ago.

Strong Mayor will see Reforms Through

The will, on my part, to make these changes now is the single most important difference. I hope and expect that voters will hold me and my fellow elected officials accountable as well for whether or not we implement these reforms.

Some would argue there has never been the money to effectively implement recommendations. There still isn't the money but we simply have no choice. And therefore, I will have some very hard choices to make. But again, I believe that the time to act is now.

Clearly, we need to proactively address and correct the clear and convincing patterns of mismanagement and negligence that Kroll clearly detailed.

The way to do that is by implementing processes that correct this behavior and being steadfast in our resolve that this will never happen again.

SEC will give City Credit for Remedial Implementation

I am not persuaded by the argument that we should hold off on adopting a remedial plan until we hear from the SEC. I think most in this community would agree that we've waited long enough.

The Kroll report painfully points out that delays have been the tradition, not the exception, at City Hall.

I do not believe that my actions will be inconsistent with what the SEC will want to see in the way of reform. In fact, it is my belief that they will give us credit for being pro-active in reforming our own affairs before being ordered to do so. Whatever their judgment may be, I will respect it and will take appropriate action when they are ready.

Auditors Want Remedial Actions

Secondly, KPMG and Macias Ginni & O'Connell, the City's outside auditors, have both told us that they are satisfied with the remedial steps found in the Kroll report.

This is critical because KPMG demanded an investigation before it would issue an opinion on our financial statements. As you all know, the issuance of audited financial statements is a requirement so that we can return to the financial markets. This is why the City Council, with the City Attorney's blessing, hired Kroll.

The audit firms have told us that if the City accepts and implements a comprehensive remedial plan that they will be prepared to issue audited financial statements. We need the outstanding audits for FY03, 04 and 05 to re-access the public credit markets.

Clearly, there were practical implications that weighed heavily on my consideration of the remedial actions. But I am also hopeful that it will spur a much needed cultural change at City Hall as well.

Financial Markets will view Reforms Favorably

Thirdly, and finally, I do believe that investors and the financial markets will judge us based upon if, how and when we implement our remediation plan.

It's incumbent on us to put the proper remedial actions in place so that they can have confidence that what previously happened at City Hall never happens again.

While Jay will brief you on the remedial actions in a few moments, I would like to speak briefly to three of the most important recommendations: the appointment of a monitor; the establishment of an Audit Committee; and the establishment and appointment of an Auditor General. I wanted to share with you my thinking on these three issues. I favor each for an entirely different reason.

Mayor Believes City Needs Monitor

With respect to the monitor, I agree with the Kroll recommendation because I believe that we need an independent third party to hold us accountable, to hold our feet to the fire.

Even if the SEC did not impose such a requirement on the City, I would still favor such a move.

As we know all too well in this City, it's easy to get lulled back – some would say, sucked back – into a sense of complacency about our affairs once the harsh glare brought by all of this attention dims. I want that glare to continue.

I will do what's right and will act in a manner consistent with reforming this City. But it is my measured opinion that we need an independent third party to continue to hold us accountable.

To validate our progress and to report to everyone – citizens and financial markets alike -- on how we are doing. I think this will be key to restoring our financial and managerial credibility on the national stage.

We need someone, with no vested interests, who can call it like they see it. Our progress – or lack thereof – deserves to be properly documented and publicly reported.

My intention is to design the scope of their responsibilities so that they are acceptable to the SEC, not duplicative of any other requests they may make of us, **and** not inconsistent with the provisions of the Charter.

Audit Committee Gives Extra, Independent Set of Eyes

With respect to the establishment of a permanent and independent Audit Committee, this is a best practice championed by the Government Finance Officers' Association. Clearly, this is an area that can stand another set of dispassionate, professional and well-qualified eyes.

Let me be clear: my conception of the permanent Audit Committee is very different from Kroll's role as the Audit Committee.

I believe that we will be able to find qualified professionals from our own community that will be able to serve on this committee without compensation.

Auditor General will be Independent

And lastly, with respect to the establishment and appointment of an Auditor General, I also believe this to be a best practice.

To insure the independence of the auditing functions and allow for the tightest set of financial controls, I have stated previously that the auditing and comptrolling functions should be separated.

I think we need to do everything possible to send a message of unqualified reform to the financial markets. As such, I believe that the level of independence that this individual will be granted will do just that.

It's for that very same reason that I believe that the office holder should be appointed with a multitude of protections that guarantee his or her independence as opposed to being elected and subject to the whims of politics.

I will recommend such a Charter Amendment at the appropriate time that will also clarify the role of the City's Chief Financial Officer.

I do not believe that a Charter Amendment will be necessary to administratively change titles not currently found in the Charter.

"Checks and Balances" Foundation of Democracy

Let me speak for a moment to the importance of checks and balances. It's the very foundation of our American democracy.

I firmly believe that the mayor should have the power to nominate all of the individuals to these three functions. I also firmly believe that the City Council should have the power and the responsibility to review and confirm or reject all of these nominations.

I do not believe that it compromises these individuals' independence to be nominated by a chief executive and confirmed by a legislative body. Quite the opposite. There are thousands of examples in our country of this very same system.

Mayor calls self “Ultimate Monitor”

While all three of these new offices will be critical players in setting things right, I am telling voters today that as their strong mayor, I am ultimately the responsible party for implementing the remediations and getting this City back on track.

I will be the ultimate monitor that ensures our compliance. While I didn't create these problems, I am responsible for fixing them. It will be my legacy to leave behind a better City government than the one that I inherited.

You have before you my 38 page plan of action that includes timeframes and projected cost estimates.

You will see that the timeframes are appropriately aggressive. I will recommend that all of the actions be implemented over the next 30 months.

Before I turn my attention to the City's financial situation, I wanted to speak – for a moment – to a few of the issues that have arisen over the past several weeks.

Mayor Recognizes Needs for some Charter Amendments

Some of the changes that we wish to make will require voter approved amendments to our City Charter.

In the meantime, I intend to conduct our City's affairs in a manner consistent with the Charter and wherever possible, make incremental steps toward the fulfillment of the expressed goal. The Audit Committee's powers and responsibilities is a good example of this.

Mayor does NOT support Kroll lawsuit

The City paid dearly for the Kroll report, \$20.3 million. I don't intend to pay the firm any additional funds.

Kroll has recently informed me via letter that the threat of potential litigation may force them to further bill the City.

I do not support suing Kroll. I don't think it will get us anything and in fact, may cost us dearly both in terms of money and misdirected resources. This will not advance our strategy of moving the City forward or getting it back on firm financial ground.

While I certainly do not agree with the final price tag nor do I agree with the process, I think that the City is as much to blame. The simple truth is that the City entered into an open ended contract that imposed few – if any – constraints on the vendor.

Let me turn now to the City's financial picture to include the costs of the remedial plan. Again, I want to emphasize that the implementation of this plan will not address the City's chronic financial problems.

Financial Reforms Critical

Without widespread, fundamental financial reform at all levels, those problems will never be corrected. In fact, without reforms, the City will not be able to afford the cost of the remedial plan.

I think that this plan gives me a very valuable opportunity to make important changes to the cost centers of City government.

As I have said previously, I think the cost of the benefits that we provide to our employees combined with the costs of the services that we provide to our citizens is unsustainable.

It's simply not realistic to believe that we can continue to operate in this kind of chaotic budgetary environment. We end up doing nothing right.

It's our early estimate that the implementation of the remedial actions will cost upwards of \$45 million over the next 7 years alone. This is a very conservative estimate that will be subject to refinement.

In addition, there are a number of other issues, separate from those that can clearly be defined as remedial actions, that the City would have – or should have -- had to pay anyway.

To date, there has not been a game plan on how to pay these obligations. I will put one forward.

These include such line items as:

- The cost ramifications of the manner in which the Retirement System addresses net gains and losses;
- the cost increase that could come from the Retirement System adopting revised actuarial assumptions, including a revised amortization schedule;
- tax compliance for the past retiree healthcare payment liabilities;
- increased payments to address our deferred maintenance;
- increased contributions to fund the UAAL for retiree healthcare;
- and increasing our operating reserves to reduce the cost of borrowing.

We have yet to determine the total magnitude of the issue. In the spirit of greater transparency and so that we can get a sense of the total costs associated with the remedial actions, I have asked our CFO to work toward grouping all of the costs together.

I firmly believe that any conversation about the costs of the remediation plan should be held within the broader context of the City's long range financial picture. I did not think it would be responsible to piece meal this discussion.

Mayor to Offer 5 Year Plan

As such, I intend to present the Council with a 5 year budget plan. The plan will include the costs of the remedial actions as well as the other line items I just detailed. It's my goal to present this plan to the Council by the end of the year.

The plan will provide a roadmap for how we get the City back on more stable financial footing.

Mayor will NOT Support Tax Increases

I want to be clear that I will not propose or support any tax increases.

I think that voters appropriately expect that government should be able to live within its means, just as citizens do in their own homes across our City. Consequently, we will have to make cuts to the costs of operating City government.

This is one of the reasons why I place such importance in BPR, or business process re-engineering. The reviews that are going right now will help us to make government more efficient, to reduce costs by eliminating waste and by working to maximize revenues.

But ultimately, I believe that there will also be some tough decisions on the horizons.

I will communicate all of my budgetary proposals, including how we account for long term liabilities, as part of my 5 year plan.

I don't want to go too far because we are still in the development stages for the budget plan but I think that it's safe to say that I envision a much smaller City workforce in the future.

I also believe that City services will have to match our resources and our priorities. We can't – and won't – be all things to all people. Our resources simply won't allow it.

I have often said that I can't print money. Even when we succeed in making government as efficient as it can possibly be, there will still be an important element of sacrifice needed to get this City back on track.

City Should Access Public Credit Markets by February, 2007

Lastly, today, we will also present you with a new timeline for re-accessing the public credit markets.

Jay will review this at the end of his presentation but it's my sense that right now that we should have ratings by the end of February of next year.

This would mean that by no later than the beginning of June of next year, the City should be able to begin long-delayed major infrastructure projects.

Thank you for your attention today.

Time for Action is NOW

The time for action is now -- today. I ask that you adopt the principles outlined in my remedial plan. This City has waited long enough.

Clearly, there is an understanding that any changes in appropriations, the Charter or the Municipal Code will return to the Council.

Today is not the day to delay. Again, I ask you to adopt the principles in my remedial plan.

Thanks.